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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

CC Docket #96-98
~~6/26/97~~ 7/30

In the Matter of)
)
Request by ALTS for Clarification of the) File No. CCB/CPD 97-30
Commission's Rules Regarding Reciprocal)
Compensation for Information Service Provider)
Traffic)

REPLY COMMENTS OF U S WEST, INC.

U S WEST, Inc. ("U S WEST") hereby submits these Reply Comments in the above-captioned proceeding.¹

On June 20, 1997, the Association for Local Telecommunications Services ("ALTS") filed a letter with the Federal Communications Commission ("Commission") requesting "clarification" that local exchange carriers ("LEC") are entitled to receive reciprocal compensation (pursuant to Sections 251(b)(5) and 252(d)(2) of the Telecommunications Act of 1996) whenever they receive and terminate traffic from another LEC and deliver that traffic to an Enhanced Service Provider ("ESP") premise.² In initial comments in response to the ALTS letter,

¹ Request for Expedited Letter Clarification -- Inclusion of Local Calls to [Information Service Providers] ISPs Within Reciprocal Compensation Agreements, CC No. 96-98, dated June 20, 1997 ("ALTS letter"). And see Public Notice, Pleading Cycle Established For Comments On Request By ALTS For Clarification of the Commission's Rules Regarding Reciprocal Compensation For Information Service Provider Traffic, CCB/CPD 97-30, DA 97-1399, rel. July 2, 1997. Order extending reply comment date, DA 97-1543, rel. July 22, 1997.

² The ALTS letter deals primarily with what are called Internet Service Providers, and the class of services affected are more and more commonly known as

ESPs and competitive LECs ("CLEC") lined up behind ALTS, while incumbent LECs ("ILEC") opposed the ALTS request. U S WEST is in the unique position of falling into all three camps — it provides service to the public as an ILEC, as an ESP (as well as an ISP) and as a CLEC. Thus U S WEST is unable to polarize the issue raised by ALTS in quite the simple fashion accomplished by the initial commentors. These Reply Comments are submitted in an effort to bring some perspective to a complex and difficult issue of which the matter raised by ALTS is merely a symptom.

As an initial matter, it seems appropriate to eliminate from consideration in this proceeding most of the adjectives flung about by some commentors. While the position taken by ILECs on the matter of paying reciprocal compensation to CLECs for termination of one-way traffic delivered to an ISP or other ESP may seem problematical to some industry players and regulators, it is hardly "profoundly anticompetitive," demonstrative of a "continuing willingness to use . . . market power to thwart the development of competition," or evidence of "denouncing the Commission's local competition rules . . ."⁴ The continuation of implicit subsidies and other anomalous rate structures (federal and state) in an increasingly competitive marketplace is both dangerous and ultimately doomed, and the problem

Information Services, provided by Information Service Providers, or ISPs. Perhaps as a matter of nostalgia as much as anything else, U S WEST refers to the affected services herein as enhanced services, the classification which is actually recognized in the Commission's applicable rules.

³ Comments of Cox Communications, Inc., filed July 17, 1997 at 2.

⁴ Comments of MCI Telecommunications Corporation, filed July 17, 1997 at 2.

which ILECs have with the payment of mutual compensation for termination of ESP traffic is a direct outgrowth of one of these pricing anomalies — the ESP exemption. Moreover, existing intrastate retail rate structures exacerbate this problem further, creating another anticompetitive situation which adversely affects CLECs and ILECs alike. Such silly rhetoric can only serve to detract from the serious nature of the issues raised by ALTS.

From the CLECs' perspective, the problem is a simple one. A CLEC incurs the same costs in terminating traffic to an ESP as it does terminating traffic to any end user (we eschew for now being drawn into the debate over whether an ESP is a "real" end user or a phony end user). ILECs are forced by the Commission to treat ESPs as end users for interstate access charge purposes, which means that they do not recover termination costs from ESPs. Thus, as a practical matter, CLECs cannot assess termination charges to ESPs without putting themselves at a competitive disadvantage in attracting ESP customers. Today, the costs of terminating ESP traffic are generally borne by the ESPs' customers and the general body of ratepayers. Thus, as a practical matter, a terminating LEC which does not receive reciprocal compensation for terminating a call to an ESP will not be compensated directly for terminating that call.

By the same token, the reason why ESPs are charged their current rates by ILECs is that the Commission itself has created a series of regulatory anomalies (generally reproduced and expanded on by state regulators) which incent many ESPs to make costly and inefficient use of ILECs' networks. Thus, in the eyes of ILECs, the ILECs are being underpaid for traffic delivered to an ESP when that

ESP purchases terminating service from the ILEC. To pay another LEC reciprocal compensation for service which is already under water, and which can be seriously disruptive to the ILEC's network as well, can be well seen as simply adding insult to injury.⁵

U S WEST's primary concern is that the Commission not, through well-meaning but unrealistic regulatory policies, create and maintain artificial incentives for data service providers⁶ to make extensive and uneconomic use of circuit switching technology offered by carriers which they would not use if free market forces could operate to match costs, prices and efficiency in a natural manner. U S WEST believes that the public interest will be best served by the development of an overlay network for access to the Internet and other ESPs. Such an overlay network could provide two important benefits. First, low-speed dial-up access to ESP services could be facilitated by the shifting of traffic from the interoffice networks of all LECs onto an overlay network of packet switches. Such

⁵ U S WEST described in detail the potential harms to the circuit switched network caused by interconnected packet networks in its comments and reply comments in the Access Charge Reform proceeding, CC Docket No. 96-262, et al. See Comments of U S WEST, Inc. In Response to Notice of Inquiry Concerning Information Service Providers, CC Docket Nos. 96-262, 94-1, 91-213 and 96-263, filed Mar. 24, 1997 at 5-8, 20-22 and Exhibit B, and Reply Comments of U S WEST, Inc., CC Docket Nos. 96-262, 94-1, 91-213 and 96-263, filed Apr. 23, 1997 at 10-13 and Exhibit B.

⁶ Adelphia Communications Corporation defines the Internet as a gigantic international computer — sort of a globe-wide end user. Comments of Adelphia Communications Corporation, et al., filed July 17, 1997 at 18-19 ("Adelphia"). Under Adelphia's concept, once the Internet has received traffic, the entire remainder of the transaction is private. The implications of Adelphia's analysis are enormous, and probably deserve a separate docket all to themselves. For access charge purposes, however, it would seem that Adelphia has properly characterized the Commission's position.

an overlay would be more efficient and less costly than the existing circuit switched interoffice transport network, would provide increased throughput, and would provide relief to the traffic blockages that are affecting both Internet access as well as traditional voice traffic.

Second, an overlay network can offer the public higher bandwidth connections to the Internet through the use of cable modems and xDSL technologies. As pointed out in U S WEST's comments in the Access Charge Reform proceeding,⁷ the existing ESP exemption from switched access charges is providing an incentive to ESPs to continue uneconomical use of circuit switched services because no ILEC charges end users on a usage sensitive basis for call termination. Thus, ESPs and their customers are motivated to establish holding times far in excess of what they really need for service because such holding times do not cause a cost to be incurred — either by the ESP or the ESP customer. But these long holding times do cause the LEC to incur additional costs. As costly circuit switching service is received without offsetting cost incurrence, there is no motivation for ESPs or their customers to seek technologies or services which would reduce the holding time impact caused by use of circuit switching technologies.

Reciprocal compensation in the ESP context can increase the artificial incentive to use circuit switching technology to connect to ESP data networks because the terminating LEC serving the ESP would receive payment from the originating LEC serving the ESP's customer — payment which would not be

⁷ See note 5, supra.

received if the ESP were the originating LEC's customer. The terminating LEC would be receiving compensation for terminating traffic which the originating LEC would not. In other words, because of the way the Commission and other regulators have set up the regulatory structure for ESPs, compensation for ESP traffic begins to match cost only when two LECs are involved. When a LEC delivers traffic to an ESP directly, no compensation is paid (beyond, of course, local charges and the interstate charges associated with the line). This is so even if the traffic is entirely interstate in nature. When the same LEC delivers traffic to another LEC for delivery to an ESP, reciprocal compensation would be paid under the ALTS position, but denied under the NYNEX position.⁸ However, when the same originating LEC delivers traffic to an interexchange carrier ("IXC"), interstate access charges are received by the originating LEC, rather than the originating LEC paying reciprocal compensation for exactly the same service. Of course, under the Commission's current rules, when the originating LEC delivers the same traffic to the second LEC pursuant to an interconnection agreement for delivery to an IXC, access charges are not paid, but neither is reciprocal compensation. In other words, originating and terminating LECs are faced with a bewildering and conflicting array of compensation schemes based entirely on who the traffic is delivered to. We submit that the economic signals given by such a government-mandated pricing regime make rational market or technological deployment impossible. Such

⁸ For an example of NYNEX's position see the April 15, 1997 letter from Patrick A. Garzillo, NYNEX, to Thomas E. Allen, Intermedia Communications Corp., attached to the ALTS letter.

economic signals clearly disrupt rational deployment of an overlay network for data services which normal market and technological forces would ordinarily drive to.

Several brief observations are in order concerning the ALTS letter.

First, the recent decision of the Eighth Circuit Court of Appeals in Iowa Utilities Board v FCC,⁹ vacated the Commission's reciprocal compensation rules. Under the logic of Iowa, proper interpretation and application of the reciprocal compensation provisions of the 1996 Act are vested by statute in state regulators. While we agree that the Commission is not without power to resolve at least some reciprocal compensation issues, now would seem to be a particularly bad time for the Commission to hop into a pricing area where the Commission's rules have been explicitly vacated.

Second, the fact that almost all ESP traffic is terminating complicates the reciprocal compensation issue and creates the potential for creation of an industry based on arbitrage, something which seems like a singularly bad idea. All of the commentators operate on the assumption that CLECs and ILECs alike will offer full service to a variety of customers, and ESPs will be merely one of many classes of customer they serve. In an environment where all LECs offer a full array of services, it seems fair to assume that all such carriers' customers will be calling ESPs served by other LECs, and that reciprocal compensation will generally balance out, at least in the long run.

⁹ Iowa Utilities Board, et al. v. FCC, No. 96-3321, Opinion filed July 18, 1997 (8th Cir.).

However, it must be noted that in a reciprocal compensation situation, an ESP will be a particularly valuable customer. This is because practically all ESP traffic is terminating. An end-user customer calls the Internet, not visa versa.¹⁰ A specialized carrier which served only ESPs could essentially, under some theories of reciprocal compensation, receive a lopsided reciprocal compensation amount, because it could terminate other carriers' traffic for a fee but originate no traffic of its own. This scenario would (or at least could) motivate a carrier to attempt to entice ESPs to become their customers because of the reciprocal compensation the ESP would bring with it, not because normal business judgment would create the incentive for the carrier to serve the ESP. It might even make economic "sense" for the LEC to pay the ESP to become its customer, thus sharing the reciprocal compensation benefits. The "one way carrier" problem could prove especially problematic if Internet traffic over circuit-switched networks ever becomes really extensive (which is predicted), or if voice on the Internet becomes common (which is also expected).

Third, it is important to put the jurisdictional issue in perspective. ILECs note that Internet (and other ESP traffic) is jurisdictionally interstate, and conclude therefrom that such traffic does not "terminate." Hence, they conclude, reciprocal

¹⁰ This is true even when the end-user customer receives messages from the Internet, such as is the case with electronic mail. The end-user customer calls the Internet, and then receives his or her electronic mail.

compensation is not appropriate.¹¹ Others commentators contend that ESPs are end users, but split on whether their traffic is interstate or intrastate.¹² Everyone seems to contend that the Commission has preempted state regulation over the local rates charged to ESPs and has mandated that ESPs be charged the same rates as others treated as end users under intrastate tariffs. We submit that the Commission, in proclaiming that ESPs are end users, has left the matter of the intrastate rates to be paid by such end users up to state regulatory agencies. While states seem to have uniformly chosen to treat ESPs as end users for intrastate pricing purposes, there is not (nor has there been) any compulsion that they do so. When the Commission chose to exempt ESPs from payment of access charges, it, by necessary implication, left the matter of the local rates to be paid by ESPs to state authorities.

Overall, U S WEST submits that the ALTS letter presents the Commission with yet another reminder that pricing anomalies, regulatory pricing distortions and implicit subsidies distort normal economic incentives and are ultimately anticompetitive. The existence of the ESP exemption puts all parties in an impossible position when dealing with the issue of reciprocal compensation for ESP traffic, because any resolution will be made unfair to someone by virtue of the continuation of the ESP exemption.

We submit that the jurisdictional issue makes unilateral Commission action

¹¹ See, e.g., Comments of Ameritech, filed July 17, 1997 at 4-8; Comments of Cincinnati Bell Telephone Company, filed July 17, 1997 at 2-3; Comments of the Southern New England Telephone Company, filed July 17, 1997 at 3-4.

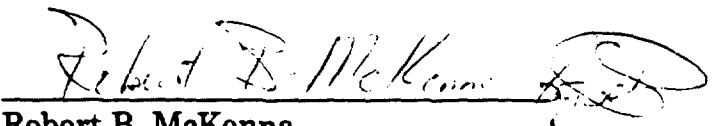
¹² See, e.g., Comments of ACC Corp., filed July 17, 1997 at 5-6; Adelphia at 3; Comments of America Online, Inc., filed July 17, 1997 at 7.

on the ALTS letter imprudent at this time. However, the Commission has a very real problem on its hands, one with extremely significant intrastate as well as interstate aspects. The Commission should take action to initiate a joint resolution of the ESP exemption and related issues, including intrastate retail pricing anomalies. Among the factors would be how regulators could avoid erecting barriers to the economic development of an overlay network for data traffic. Perhaps a joint board convened pursuant to 47 U.S.C. Section 410(b) would be an appropriate device to commence such a proceeding.

Respectfully submitted,

U S WEST, INC.

By:



Robert B. McKenna

Suite 700

1020 19th Street, N.W.

Washington, DC 20036

(303) 672-2861


Its Attorney

Of Counsel,
Dan L. Poole

July 31, 1997

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 31st day of July, 1997, I have caused a copy of the foregoing **REPLY COMMENTS OF U S WEST, INC.** to be served via first-class United States Mail, postage prepaid, upon the persons listed on the attached service list.



Kelseau Powe, Jr.

***Via Hand-Delivery**

(CC9698Q.COS/BM/ss)

***Reed E. Hundt**
Federal Communications Commission
Room 802
1919 M Street, N.W.
Washington, DC 20554

***James H. Quello**
Federal Communications Commission
Room 814
1919 M Street, N.W.
Washington, DC 20554

***Susan P. Ness**
Federal Communications Commission
Room 832
1919 M Street, N.W.
Washington, DC 20554

***Rachelle B. Chong**
Federal Communications Commission
Room 844
1919 M Street, N.W.
Washington, DC 20554

***Regina M. Keeney**
Federal Communications Commission
Room 500
1919 M Street, N.W.
Washington, DC 20554

***James D. Schlichting**
Federal Communications Commission
Room 518
1919 M Street, N.W.
Washington, DC 20554

***Wanda M. Harris**
Federal Communications Commission
Room 518
1919 M Street, N.W.
Washington, DC 20554

***Edward B. Krachmer**
Federal Communications Commission
Suite 518
1919 M Street, N.W.
Washington, DC 20554

(2 Copies)

***International Transcription
Services, Inc.**
1231 20th Street, N.W.
Washington, DC 20036

Richard J. Metzger
Association for Local Telecommunications
Services
Suite 560
1200 19th Street, N.W.
Washington, DC 20036

Gary L. Phillips
Ameritech Telephone Companies
Suite 1020
1401 H Street, N.W.
Washington, DC 20005

G. R. Evans
NYNEX Government Affairs
Suite 400 West
1300 I Street, N.W.
Washington, DC 20005

Warren D. Hannah
Leon M. Kestenbaum
Jay C. Keithley
Sprint Corporation
Suite 1100
1850 M Street, N.W.
Washington, DC 20036

Jean L. Kiddoo
Kathy L. Cooper
Antony Richard Petrilla
Andrew D. Lipman
Swidler & Berlin, Chartered
Suite 300
3000 K Street, N.W.)
Washington, DC 20007
(6 Copies)

RCN
WORLD COM
ACC
FCI
WINSTAR
USX

Joseph Kahl
RCN Telecom Services, Inc.
2nd Floor
105 Carnegie Center
Princeton, NJ 08540

Donald T. Dunning
Dicks and Dunning, LLP
2310 Symphony Towers
750 B Street
San Diego, CA 92101-8122

NCCC

David N. Porter
WorldCom, Inc.
1120 Connecticut Avenue, N.W.
Washington, DC 20036

Raymond G. Bender, Jr.
J. G. Harrington
Werner K. Hartenberger
Dow, Lohnes & Albertson
Suite 800
1200 New Hampshire Avenue, N.W.
Washington, DC 20036-6802

VANGUARD
COX

(2 Copies)

Lawrence G. Malone
New York State Department
of Public Service
Three Empire State Plaza
Albany, NY 12223-1350

Randolph J. May
Sutherland, Asbill & Brennan
1275 Pennsylvania Avenue, N.W.
Washington, DC 20004

COMPUSERVI

Mark Stachiw
AirTouch Paging
Suite 800
Three Forest Plaza
12221 Merit Drive
Dallas, TX 75251

Jonathan E. Canis
Lisa L. Leibow
Kelley, Drye & Warren, LLP
Suite 500
1200 19th Street, N.W.
Washington, DC 20036

INTERMEDIA
ACSI

(2 Copies)

Kecia Boney
Lisa B. Smith
MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006

Teresa Marrero
Teleport Communications Group, Inc.
Two Teleport Drive
Staten Island, N.Y. 10311

Mary McDermott
Linda Kent
Keith Townsend
Hance Haney
United States Telephone Association
Suite 600
1401 H Street, N.W.
Washington, DC 20005

Donna N. Lampert
Christopher J. Harvie
James J. Valentino
Mintz, Levin, Cohn, Ferris,
Glovsky & Popeo, PC
Suite 900
701 Pennsylvania Avenue, N.W.
Washington, DC 20004

AOI

George Vradenburg, III
William W. Burrington
Jill A. Lesser
AMERICA ONLINE, Inc.
Suite 400
1101 Connecticut Avenue, N.W.
Washington, DC 20036

Cheryl A. Tritt
Charles H. Kennedy
Morrison & Foerster
2000 Pennsylvania Avenue, N.W.
Washington, DC 20006

BFP

Ronald L. Plesser
Mark J. O'Connor
Piper & Marbury, LLP
7th Floor
1200 19th Street, N.W.
Washington, DC 20036

CIEA

Glenn B. Manishin
Christine A. Mailloux
Blumenfeld & Cohen
Suite 700
1615 M Street, N.W.
Washington, DC 20036

SPECTRANET

Kathleen A. Carrigan
Southern New England Telephone
Company
227 Church Street
New Haven, CT 06510

Christopher J. Wilson
Christine M. Strick
Frost & Jacobs
2500 Central Trust Center
201 East 5th Street
Cincinnati, OH 45202

CBTC

Thomas E. Taylor
Cincinnati Bell Telephone Company
6th Floor
201 East 4th Street
Cincinnati, OH 45202

Riley M. Murphy
Charles H. N. Kallenbach
American Communications
Services, Inc.
Suite 100
131 National Business Parkway
Annapolis Junction, MD 20701

Mark C. Rosenblum
Ava B. Kleinman
Seth S. Gross
AT&T Corp.
Room 3252J1
295 North Maple Avenue
Basking Ridge, NJ 07920

Christopher W. Savage
Robert G. Scott
Cole, Raywid & Braverman
Suite 200
1919 Pennsylvania Avenue, N.W.
Washington, DC 20006

ADELPHIA, etal

Robert V. Zenner.
Richard M. Rindler.
Michael W. Fleming
Swidler & Berlin, Chartered
Suite 300
3000 K Street, N.W.
Washington, DC 20007

KMC
DOBSON
GST
HYPERION
XCOM
Business Telecom

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(6 Copies)

Anthony M. Copeland
Business Telecom, Inc.
Suite 500
4300 Six Forks Road
Raleigh, NC 27609